Remarks by

Thomas J. Curry

Comptroller of the Currency

Before the

Prudential Bank Regulation Conference

Washington, D.C.

June 9, 2015

Good morning. It's a pleasure to be here with you today and to have this opportunity to talk about how our approach to prudential supervision has evolved in the days since the financial crisis, which John Dugan and I both lived through in our former government roles.

The role of prudential supervision, with its focus on safety and soundness, isn't always fully appreciated. But it is a key defense against financial instability, and it has helped ensure decades of prosperity. Today, seven years into a tepid recovery, we are seeing a decline in credit underwriting standards as banks reach for yield and loan growth. The overall environment also is more volatile as a result of economic and international uncertainties and ongoing market and regulatory changes. These conditions pose new challenges to prudential supervisory agencies such as the Office of the Comptroller of the Currency.

I'm not trying to suggest that enforcement is not also important. In my term as Comptroller, we have not shrunk from bringing very significant actions, some of which included large financial penalties, when we have found lapses or violations of law that resulted in harm to bank customers or threats to safety and soundness.

But as we've seen, when the banking system falters—particularly when a very large institution or a sizeable group of institutions gets into trouble—the entire economic system suffers. Our goal as prudential supervisors is not just to ensure compliance with laws and regulations—important as that is—but to identify weaknesses in lending, liquidity, and operational risk management, as well as other threats to safety and soundness, and then to compel change.

By engaging with bank management early, when problems are most manageable, we have succeeded more often than not in maintaining a safe and sound system of national banks and federally chartered saving associations, which has helped assure the stability of the entire financial system.

I wish I could say there have been no exceptions, but of course we have just lived through the most significant financial crisis since the Great Depression, and so our task—and the subject of my remarks today—is to continue to improve the system to ensure that the banks we supervise remain strong even in the face of future market disruptions.

Sitting here today, it may be hard to recall how truly frightening the crisis was. At its low point, confidence in banks was all but gone and so was the confidence of banks in each other. In September of 2008, confidence was so low that they essentially stopped lending to each other. During those first years, job one—in fact the only job—was holding the system together.

As the crisis receded, however, the administration, Congress and the financial regulatory agencies began to consider how we could prevent future disruptions. Among the responses was the Dodd-Frank Act, which the OCC and the other bank regulatory agencies have largely finished implementing through a series of rulemakings. Another was the domestic capital rule, which compelled banks—and large banks in particular—to increase both the quantity and quality of the capital they hold.

My view is that those steps have made the system safer, sounder and more resilient—and by a wide margin. It's frankly hard to overestimate the impact of Dodd-Frank. The Volcker Rule, the Financial Stability Oversight Council, risk retention, enhanced resolution authority—these and a dozen other important provisions of that historic law laid the groundwork for a safer and more stable financial system.

However, the crisis that took hold in 2008 wasn't the first such meltdown that we've experienced in my lifetime, and it's instructive to look back. A quarter century earlier, the savings and loan industry was on the ropes and its insurer was bankrupt. Reacting, Congress approved a bailout in 1989 that ultimately required appropriations of more than $100 billion—a sum that seemed almost unimaginably large at the time. Two years later, with the Federal Deposit Insurance Corporation essentially broke, Congress stepped in again with rescue legislation.

That legislation, the FDIC Improvement Act, built upon reforms in the 1989 bailout law by mandating prompt corrective action, risk-based insurance premiums, requirements for regular on-site examinations, and other provisions intended to limit rescues of large banks. Those were all sensible steps, and many observers thought the system had been made safe for generations to come.

But all the reforms of those two laws did not prepare financial institutions or regulators for the trauma of 2008 and the recessionary years that followed. So while we at the OCC welcomed the tools provided by Dodd-Frank and believe they have greatly strengthened the financial system, we also recognized early on that new statutory authority was not enough to ensure the safety and soundness of our largest banks and the stability of the financial system as a whole. What was also needed was a complete rethinking of how we supervise our largest and most complex banks, particularly those that pose the greatest systemic risks.

In the wake of the crisis, we began working on new standards to raise the bar for our largest institutions—essentially those with more than $50 billion in assets. We first introduced these new standards to our large banks in 2010 in the form of what we termed "heightened expectations," and essentially field tested them through the supervisory process, assessing compliance and incorporating our findings into the risk assessment of those institutions.

Progress towards achieving these expectations was too slow. It became clear that a more robust approach, providing for the possibility of an enforceable response, was needed. In January 2014, the OCC released proposed guidelines and, in September, adopted final guidelines as a new appendix to Part 30 of our regulations. The final guidelines allow the OCC to pursue progressively tougher remedies, up to and including an enforcement action, to ensure compliance.

The guidelines have two major components. The first sets forth the minimum standards for the design and implementation of a covered bank's risk governance framework, stipulating that it should include well-defined risk management roles and responsibilities for what the industry commonly refers to as the three lines of defense: front line units, independent risk management, and internal audit.

The risk governance framework and the three lines of defense are intended to ensure that the bank has an effective system to identify, measure, monitor, and control risk-taking and standards of behavior. Those units must ensure that boards of directors have enough information on their bank's risk profiles and risk management practices, so that the bank operates within the risk appetite statement.

Under the OCC's heightened standards, large banks are required to develop risk appetite statements that define both quantitative and qualitative parameters for safe and sound operating environments. The guidelines require that these statements address the question of how the bank will assess and accept risks, articulating behavioral expectations that shape risk culture. In addition, quantitative limits on risk-taking should incorporate sound stress testing processes and address banks' earnings, capital, and liquidity positions.

The second component of our heightened standards guidelines pertains to the responsibilities of large banks' boards of directors. It provides that bank boards should have at least two independent directors and that all board members should have the information they need for effective oversight, including the ability to pose a credible challenge to management. The guidelines also require each bank to establish and maintain an ongoing training program for all board members and conduct an annual self-assessment of the board's effectiveness in meeting the standards for the board that are articulated in the guidelines.

One important aspect of our guidelines is a requirement that a large bank's compensation and performance management programs complement and support its overall risk governance framework. It's important that these programs prohibit incentive-based payment arrangements that encourage improper risk-taking.

Before finalizing the guidelines, we accepted comments, and it was interesting to me that a number of commenters not only expressed support for the compensation provisions, but also asked that those provisions be made stronger and more specific. We chose not to do so because we and a number of other federal agencies were at work on an incentive-based compensation regulation required by the Dodd-Frank Act that covers many of the same issues. While the rule is still in process, I want to be clear that we assess compensation structures as part of our ongoing supervision, as well as for the largest banks under our heightened standards.

Let me also be clear that I regard the incentive compensation rule as extremely important. Improperly structured compensation plans were a major factor in the financial crisis. They encouraged inappropriate risk-taking and gave employees incentives to place their own financial well-being above the interests of their firm. This misalignment of interests contributed to the excessive short-term risk-taking that compromised financial stability and threatened the entire financial system. This has been an exceedingly long rulemaking process, even if I understand the reasons, and I am working to see to it that we are nearing the end of the process.

Fortunately, the industry hasn't been idle, and, as our heightened standards guidelines demonstrate, neither have we. Some banks have taken the initiative to implement compensation systems that achieve a better balance of risk and reward. They are considering how best to structure these systems, how to calibrate the right mix of current and deferred compensation, and whether and to what extent salaries and bonuses should be paid in the form of company debt or equity or both, so that all employees have a material stake in the institution's long-term success as well as their own.

Many of these expectations and requirements are simply attributes of a strong risk culture, and the health of the corporate culture at our large banks is something we've been very focused on in recent years. Culture is a bit more amorphous and more difficult to quantify than other standards, such as capital or liquidity. But it's just as important, and in some ways more important. Many of the compliance, operational, and safety and soundness problems we've seen over the past decade could never have happened in organizations with healthy cultures, and so our approach to prudential supervision today includes an assessment of organizational values.

Healthy culture starts at the top, and we look to the board of directors and senior management to set a tone that encourages ethical and responsible behavior and demands individual accountability for failure to act accordingly. It's the job of the board, in combination with management, to articulate what the institution stands for—as well as what it does not stand for—and to make clear what is not acceptable behavior. We don't expect directors to manage the bank, but we do expect the board to look at high level issues that relate to culture, from the compensation structure to how management deals with deviations from the standards the board has established.

Finally, let me say that while we have been very focused on standards for our large banks, we have been equally focused on ourselves. While models and stress tests are valuable tools for supervisors, there is no substitute for boots on the ground to assess what is actually happening inside the largest institutions. Because the role of onsite examiners is so important, none of the supervisory agencies can afford to stand still. All of us need to engage in a process of continual improvement aimed at ensuring that we are ready to meet not just today's challenges, but the evolving risks that will confront the industry tomorrow.

The OCC did just that by implementing the recommendations of a group of international bank supervisor peers that critically evaluated our large and midsize bank supervision programs. One of the important attributes of the peer review was the international participation. It allowed us to take advantage of different approaches and different ways of thinking. And it's emblematic, I think, of the way in which we are increasingly working with our peers on a global basis on supervisory issues.

We do that through a number of international committees, including the Basel Committee, as well as supervisory colleges that allow for a multinational review of large institutions with global foot prints. These supervisory colleges bring together regulators from multiple countries to review individual banks with operations inside our respective borders. It helps each of us look at the bank in its totality, and I would add that we learn from each other as we go.

I think these are all meaningful steps that have improved our approach to prudential supervision, and enhanced the stability of the financial system. But while the system is stronger and more resilient, it is not immune to the threat of future disruptions. So, our challenge is to continue to build on the improvements we have made, both in the industry and among the regulators, so that the system continues to adapt to meet the needs of a changing marketplace and the challenge of evolving risks.

Thank you.